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October 19, 1994

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222, 1919 M Street, N.W.
Washington, D.C. 20554

Re: Ex Parte Presentation in MM Docket No. 93-215

Dear Mr. Caton:

Pursuant to the Commission's ex parte rule, 47 C.F.R. § 1.1206, enclosed herewith are two copies of a letter from John Pestle, Esq., delivered to Mr. Blair Levin, Chief of Staff of the Federal Communications Commission on October 19, 1994 in MM Docket No. 93-215.

Please contact the undersigned if you have any questions regarding this matter.

Respectfully submitted,

VARNUM, RIDDERING, SCHMIDT & HOWLETT

Patrick A. Miles, Jr.

PM/kl

cc: Meredith J. Jones, Esq., Chief, Cable Services Bureau
Gregory J. Vogt, Esq., Deputy Chief, Cable Services Bureau
William Johnson, Esq., Deputy Chief, Cable Services Bureau
Patrick Donovan, Esq., Chief of Policy and Rules Division, Cable Services Bureau
Mary Ellen Burns, Esq., Chief of Consumer Protection Division, Cable Services Bureau
Lisa Higginbotham, Esq., Senior Staff Attorney, Consumer Protection Division, Cable Services Bureau

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JOHN W. PESTLE

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October 19, 1994

Mr. Blair Levin
Chief of Staff
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Ex Parte Presentation in MM Docket No. 93-215

Dear Mr. Levin:

Our thanks to you and to the Cable Bureau staff for taking the time to discuss with representatives of NATOA yesterday aspects of the going forward rules which the FCC has under consideration. As you suggested, we are providing written comments on a few of the points we discussed on behalf of the more than 200 cities, villages, and townships ("municipalities") for whom our firm is special counsel on cable matters. These comments reflect our clients' experience which range from those of large cities with over one million population (such as the City of Detroit) to communities with a population of 500 people. It also represents experiences with both the largest cable operators in the country (TCI, Continental and the like) as well as with small and medium sized cable operators.

Due to time constraints and the goal of getting written comments to you as soon as possible, we are not commenting on a number of points. However, we understand that NATOA or other NATOA members are commenting concurrently on a wide variety of points and support their comments. Two copies of this letter have been submitted to the Secretary in accordance with the Commission's ex parte rule.

Background: We understand that the Commission is considering two new proposals: The first is a "new product tier" which would be offered as a cable programming service tier offering, no one would be forced to buy it and the Commission would at least temporarily forebear from regulating this tier so long as certain requirements are met.

The second proposal the Commission is considering is a "safe harbor" for adding new channels subject to an overall price cap for the total number of new channels added. In general it follows the price formula that (a x b) + f = c, where "a" is a per channel fee, "b" is the number of channels, "f" is the license fee and "c" is the price cap.

Our written comments are limited to the second proposal. Press reports have set the price cap at $1.50. Simply for purposes of illustration I will use this number below even though you indicated that the Commission has not settled on a final number.

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Offset For Prior Increases: The $1.50 cap should be offset for prior increases which the cable operator has implemented within the past 12 months. This form of offset is needed for two general reasons: A number of cable operators (we estimate roughly a quarter to one-third of the cable systems where we represent the franchising authority) have added channels within the past 12 months. They have increased their rates accordingly under the Commission's current going forward rules. Any such increases should be offset and deducted from the $1.50 cap for two reasons.

First, you indicated that a driving force for this safe harbor is to allow additional channels to be added. Where the operator is already adding channels under the Commission's existing rules, there is obviously less need for the cap and it should be reduced pro rata so the operator can't "double-dip".

Second, the Commission has an obligation to protect subscribers and in particular to prevent "rate shock" such that subscribers do not get hit with large repetitive increases in a short period of time. As you know, protecting subscribers from rate shock is a consideration frequently taken into account by state and federal regulatory commissions.

Here this is of particular concern because many cable systems (we estimate it in the 40% range) are raising rates by approximately $1.00 in the second and third quarters of 1994 or January of 1995, principally for pentup inflationary increases (roughly 80¢) plus an additional 20¢ to 25¢ for external cost pass throughs, license fees, and the like.

The bottom line is that around 40% of all subscribers are seeing rate increases this fall in the $1.00 range.

If the Commission allows anything on the order of a $1.50 additional increase for new channels, this will mean that 40% of all subscribers will have a 12.5% increase in their rates in less than six months (basic and expanded basic collectively total around $20). To be blunt about it, this is way too much and smacks of the 15% annual average rate increases which the cable industry implemented from 1984 to 1992, and which you know was a prime reason for the passage of the 1992 Cable Act.

Simply put, the Commission should not even consider changes which encourage annual rate increases in the 10% - 12% range. To address this situation, the price cap should be reduced by all increases which the cable operator has implemented during the prior 12 months.

There is an even more fundamental reason why you should do this: As was indicated to you in the NATOA conference call, at the local level the cable operators are insistent, continuous and blatant in blaming all rate increases on the FCC. Candidly, we think they are "setting you up for a fall" on this safe harbor for adding new channels where if many subscribers experience increases in the $2 range, the cable operators (and others) will argue to Congress that you -- the FCC -- is clearly not doing its job, that the 1992 Cable Act and

cable regulation is a bust and therefore the rate regulation portions of the 1992 Act should be repealed.

Please do not underestimate the ability of the cable industry to be two-faced on this issue. Therefore please modify your safe harbor so as to offset for all prior increases in the past 12 months so that you do not run a risk of the safe harbor decimating the cable rate regulatory structure which has been so laboriously implemented over the last two years.

Inflation: The $1.50 cap for channels being added should be escalated with inflation. To prevent major rate increases in the future, it cannot and should not allow cable operators to pass through as external costs increases in licensing fees that occur in years 2, 3, and 4.

For example, we are very concerned that cable operators might obtain a number of channels for zero or nil license fee (e.g., 4¢ per customer per month) in the first year but where the license fee increases substantially (to the 50¢ and 60¢ range) in later years. Such increases might be written into the programming contract from the start or might just "happen" down the line.

A safe harbor makes sense only if it has limitations on rates in both the initial year and subsequent years. You indicated that a prime motivation for the safe harbor is to allow new channels on the system (where programmers are claiming they cannot get on at all).

Hold the programmers to their claims and don't allow them to gouge subscribers by greatly raising their license fees in later years (where such increases are an automatic external cost pass through to subscribers). Allowing the $1.50 to simply escalate for inflation (and forcing all future license fees to come within this cap) will allow those programmers to get on cable systems who are willing to be reasonable in their prices and will restrain those who are out simply to gouge the public.

Safe Harbor Apply Only to CPS Tier: We discussed briefly with you and had a much longer discussion with Mr. Donovan about the fact that the safe harbor should only apply to the cable programming services tier. The safe harbor should not apply to the basic tier for three reasons -- to prevent overburdening municipalities and harming rate regulation; to preserve customer choice; and to encourage competition, such as DBS. The reasons for each are as follows.

First, we have explained to you and we have explained to Cable Bureau staff that franchising authorities have simply run out of resources for the present and near term future for rate regulation. You heard this yesterday from two of the largest cities in the country -- Los Angeles and New York. All of the parties on the line affirmed it for their cities (or in the case of lawyers, their clients). We can tell you it is the case for many of the over 200 municipalities we represent.

Basically, municipalities expected to have to deal with one Form 393 and then a small amount of follow on work. Instead, they have had to deal with Form 393s, Form 1200s, massive a la carte evasions and complaints, as well as in some cases state court lawsuits challenging their ability to regulate. The bottom line is that municipalities operate on a budget year cycle and most of them are already well beyond the amounts they budgeted for cable rate regulation in 1994-95.

Mr. Donovan confirmed that if this safe harbor exemption is applied to the basic tier is will require a revised version of a Form 1210 to be filed with franchising authorities for them to examine. This could well be the "straw that breaks the camel's back" and cause many communities to throw up their hands and not regulate (either by ignoring the paperwork or actually filing for decertification) because the burden is beyond that which they can deal with in the current and near term future.

Based on our experience, we believe that the cable operators are fully aware of this. Some cable operators are already peddling to franchising authorities the paperwork (drafted by the operators' Washington, D.C. law firm) necessary to decertify and withdraw Form 329 complaints. And you should know that the cable operators are continuously stressing the burden of rate regulation to the local communities. For example, recently in the City of Battle Creek, Michigan (which decided this summer to regulate rates) TCI stressed how it would cost tens of thousands of dollars and involve huge amounts of paperwork.

Allowing the safe harbor to apply to the basic tier will play into this argument of the cable operators and, combined with the burdens municipalities have already experienced, cause many of them to stop regulating. You should not allow your goal of getting new programming on the system to so thwart the overall rate regulation process.

Second, there is a significant segment of the population that only wants a minimum number of channels on basic. Many of these are minority and economically disadvantaged groups who can only afford a very minimal basic cable service tier. The Commission should not encourage a large basic tier which discriminates against such group.

The bottom line is that customer choice is served with a small basic tier and then additional tiers which a customer can opt for or not, as they deem appropriate. This goal of aiding customer choice is not achieved if the additional channels are added to basic which forces all customers to buy them, whether they want to or not.

Third, encouraging channels to be added now to the basic tier will help thwart the rollout of direct broadcast satellite (DBS) service, which as you know is the major new competitor for cable. Already we have seen cable operators collapse tiers and add programming to basic and tell the franchise authority there is very simple reason for doing this: They want to load everything possible on basic to deter subscribers from taking just basic service from the cable operator (so as to get the local TV stations with a clear, ghost

free picture) and then pick up all the satellite channels from DBS. The bottom line here is the bigger the basic tier, the more you limit DBS as a true competitive threat to cable TV.

As you know, one of the principal policy thrusts of both the 1992 Cable Act and many of the Commission's rulemakings is to encourage competition for cable. To this end, make sure that this safe harbor only applies to the cable programming services tier and not to the basic tier.

Access to Contracts: If you do allow the safe harbor to apply to the basic tier, you have to make sure that franchise authorities have access to the programming contracts to verify that the price formula is being complied with. The Commission's current rules (as revised under ¶¶ 74-79 of the Third Order on Reconsideration) adequately provide for this and should not be changed.

Conclusion: It was very heartening to hear the repeated comments by you and Meredith Jones that you truly view franchising authorities as your partners in the rate regulation process. The point of these comments is to give you specific feedback from your partners as to what will and will not work at the local level and what will best achieve the broad policy objectives of Congress and this Commission, while recognizing the realities that are occurring in the field, municipal budget constraints, cable operators saying different things than they say to you, and the like.

We very much appreciate your taking the time to talk with us. Should you or Cable Bureau staff have any questions, please feel free to call Pat Miles or me at (616) 336-6000.

With best wishes,

Very truly yours,

VARNUM, RIDDERING, SCHMIDT & HOWLETT

John W. Pestle

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